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August 16, 2006

Andy Pollock
Executive Director
Nebraska Public Service Commission
1200 N Street, Suite 300, Lincoln, NE 68508

Re: Docket No. NUSF-50; Embarq Corporation's Comments in Response to Progression Order No. 2

Dear Mr. Pollock:

Please accept for filing an original and five copies of Embarq Corporation's comments in this matter. If you have any questions, please do not hesitate to contact me or Jim Roberts, at (651) 222-0951.

Sincerely,

William E. Hendricks, Esq.

BEFORE THE NEBRASKA PUBLIC SERVICE COMMISSION

In the Matter of the Commission, on its own motion, to make adjustments to the universal service fund mechanism established in NUSF-26	)))))	Application No. NUSF-50 Progression Order No. 2 Comments of United Telephone Company of the West, d/b/a Embarq

COMMENTS OF UNITED TELEPHONE COMPANY OF THE WEST d/b/a EMBARQ

United Telephone Company of the West d/b/a Embarq ("Embarq") respectfully submits these comments in response to Staff's proposal for adjustments to the permanent universal service fund mechanism established in NUSF-26, as set forth in the Commission's order in the above referenced docket, entered on July 18, 2006.

Embarq supports the Commission's efforts to reform the Nebraska universal service fund ("NUSF") mechanism. With the surcharge rate of 5.75% the fund is distributing more than it takes in. The solvency of the fund is at stake, and every effort should be made to ensure the adequacy of the fund as many small, rural telephone companies in high cost areas depend on NUSF support to help cover the cost of providing service. Without this support, the ability of these companies to continue providing affordable, quality service to their customers is in question, because they may have little or no opportunity to recover the high cost of service that is supported by the NUSF directly. Customers simply cannot afford to pay a price that reflects the full cost of providing service in high cost areas, and the ability to raise prices in more populated areas (to cross-subsidize less populated areas) is limited by competitive pressures.

Staff proposes many significant changes to the mechanism; unfortunately, the proposal provides very little detail or specifics with which Embarq could evaluate the impacts of those changes. Nonetheless, Embarq can say that the mechanism established in NUSF-26 is quite complex and therefore Embarq believes the Commission would be well-served by adopting a more measured and methodical approach to reforming the NUSF. Embarq suggests that the Commission move slowly, and consider and implement changes one at a time to ensure there is no unintended adverse impact to the fund or carriers. Accordingly, Embarq's comments below focus on a limited number of issues raised in the Staff proposal.

WIRELESS FUND

Staff proposes to fund a wireless infrastructure program, initially reserving $5M in NUSF funds with an ultimate cap of $10M. Embarq questions the need to create a *separate* fund for wireless infrastructure and the proposal offers no justification or explanation of the benefits of establishing a separate funding mechanism.

Having two separate programs with the identical goal of offsetting the high cost of providing service in rural areas is not the most efficient method of distributing scarce funds. Local telephone companies are in competition with wireless carriers, therefore both the local and wireless carriers should abide by the same rules, obligations and standards when it comes to receiving NUSF support. Thus, the fund should be technologically and competitively neutral in the distribution of available funds. Wireless companies already have an avenue for receiving NUSF funding in the form of Nebraska Eligible Telecommunications Carrier ("NETC") designation. This designation provides support in the same manner as other NETCs while ensuring compliance with the same rules, regulations, and orders.

In addition, the goal of the NUSF is to target support to the high cost areas of the state. The creation of a separate fund for wireless infrastructure, with potentially different requirements for distribution of universal service funding, may reduce funding available for wireline carriers and inadvertently shift funding away from the very high cost areas the fund was created to support.

If the Commission believes that—for reasons unspecified in the Staff proposal—it is necessary to create a separate wireless infrastructure program, Embarq recommends that the Commission increase the NUSF surcharge. The current surcharge of 5.75% does not bring in sufficient funds to cover the current needs of the existing programs. Without increasing the surcharge, creating yet another program will only compound the already tenuous funding situation and will threaten the solvency of the fund. Even without the additional wireless infrastructure program, the Commission should seriously consider raising the surcharge to cover the existing needs. A measured increase in the surcharge would not overly burden Nebraska residents, and would restore needed solvency to the NUSF program.

EARNINGS CAP

Staff also proposes to reduce the earnings cap from 12% to 11.25%, which is the federally authorized rate of return on interstate services. However, there are fundamental differences in the purposes of the Nebraska earnings cap and the federally authorized rate of return which would make using the latter in NUSF fund distribution calculations inappropriate.

First, the federally authorized rate of return is exactly that, an authorized rate of return, not an earnings cap. That authorized rate of return provides for the *opportunity* to earn an 11.25% return. Second, the 11.25% was established as the authorized return for interstate access service for companies across the United States in the early 1990s. In order to be appropriate, any rate of return must be reflective of the associated risk that an investor would incur when investing in a company engaged in a specific activity. There is no *a priori* reason that the level of risk associated with the provision of interstate access service is the appropriate level of risk associated with the provision of basic local service in an increasingly competitive market environment in Nebraska. The risk to basic local service providers in Nebraska in 2006—as competition becomes increasingly prevalent—is higher than the risk associated with the provision of interstate access service over a decade in the past. This increased risk should translate to a higher return opportunity.

Decreasing the earnings cap, while having the possible effect of reducing fund distributions, may also have potential negative consequences. The most significant negative impact of reducing the earnings cap would be the disincentive it creates for companies to improve efficiency and, in turn, make needed investment in the state.

Frontier brought this very issue to the Commission's attention in its initial comments in this proceeding. Frontier stated that "[c]ompanies operating in Nebraska should not be penalized in terms of disqualification from the NUSF mechanism simply because they are successful in increasing their efficiency and decreasing their expenses, which results in increased earnings."[1] A company, when looking at any potential new investment, is likely to produce a business case to evaluate the financial feasibility of the project. That business case will include expected changes to revenues and expenses, including any potential loss of state USF. An investment may decrease expense, and therefore increase efficiency, but may still be rejected because the loss in NUSF support may exceed the decrease in expense. The Commission should ensure that its policies encourage efficient investment; the proposal to reduce the earnings cap to 11.25% may have the opposite effect.

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[1] Citizens Telecommunications Company of Nebraska, d/b/a Frontier Communications of Nebraska initial comments filed March 22, 2006, page 5.

In summary, Embarq looks forward to working with the Commission to find a solution to the current under-funding situation in the NUSF. It is vitally important that the NUSF fund remain solvent, and that support continues to be targeted to the high cost areas, regardless of technology. That support will continue to be used to maintain and improve service in the most remote areas of the state. This is a goal from which the Commission must not stray. The easiest, and most reasonable, way of achieving this goal is to increase the surcharge.

Embarq respectfully submits these comments this 16th day of August, 2006.

By: ______________________________
William E. Hendricks

Attorney for United Telephone Company
of the Northwest, d/b/a Embarq